

Welcome to our June 2010 Newsletter

This month we're going to consider the various levels of risk associated with some of the more common property 'adding-value' strategies. There is no doubt the return on investment can be substantial, however as with any form of investment, with increased potential return comes increased risk.

Low Risk Residential Investment Strategies BUT. . . are they really low risk?

Proactive residential property strategies are those in which there is an intention to maximise total financial returns from the investment. When considered from this vantage point, it is important to understand that these strategies have increasing risk: the further down the scale the more risk. In other words renovation low risk – development high risk. In order of ranking we have:

- renovation
- strata title development
- sub-division property development

which are proactive investment strategies.

They are relatively low risk although development always carries some degree of risk. But, here we are not talking about buying land for development. Each of these proactive investment strategies can produce far greater returns than the traditional buy-an-hold strategy but are also more risky and require many more skills than just owning property.

Renovating for profit has become both an investment strategy and a kind of lifestyle choice for hundreds of thousands of Australians. Many investors make efforts to select the “worst house in the best street” in order to diminish the risk of a renovation-for-profit strategy. Here the safeguard is that a renovation in the “best” street will not suffer the risk of being over-capitalised where the cost of a renovation would not be recovered in the short term.

Data released by the Housing Industry Association shows that year-on-year renovating has been increasing while new home construction has taken a dive over the period since 2005.

There are the renovator's delights, and there are the dumps, but overriding all of this is the market.

Markets can be unforgiving and relentless in their punishment of badly conceived plans. What may have seemed like a renovator's dream to unsuspecting buyers, can turn into their worst nightmare when markets blow their 'chill winds'. Yet this is where clever people can leverage their skills and turn adverse market conditions in their favour. The adage of “turning every

renovator's dollar into four," can work but only if certain rules are followed. Renovating for profit can be a powerful strategy for a flat market but it requires building some skills and knowledge first.

Strata development involves buying a property which either has the appropriate zoning for enabling a strata development, or buying a property with the appropriate zoning in place and which requires an additional building to be built on the site or an existing building re-built to take advantage of the zoning hereby creating at least two strata "units". The potential return on investment can be significant; often many times the gain that can be achieved from a renovation.

Land development is the highest risk activity of the three and requires significant investment in both time and money. It also requires having a team in place to take the project from concept to completion. It is where the greatest (short to medium term) gains can be made.

Investing in property is a great way to build equity and wealth; it is tangible and secure. Here are a few tips to bear in mind:

- In property investing, buying well is critical: buying at a genuine discount to the market gives you an increased equity component in the property. This will grow with the growth in value of the property
- Only spend as much as you can afford and have enough money to cover any shortfall between rental income and outgoings **and** calculate your purchasing costs very carefully
- When purchasing a property as an investment, be sure that you will have enough money at the time to cover expenses that may occur, especially if there is a lag time between tenants and
- Thoroughly check the physicality of the property to ensure there are no major maintenance or repair works required

Investing in residential property is generally considered to be toward the low-end of the risk continuum. When looking to add value to residential property, you need to be aware that the degree of risk increases – from cosmetic renovation at the low-end through sub-division and multi-dwelling development at the high-end.

Until next time, great investing!

Warm regards

Garry Macdonald